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I. INTRODUCTION & OVERVIEW

THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN TELEVISION

This paper examines the impact of three major policy changes in the early and mid-1990s on the production and distribution of video content, primarily broadcast television programming in America: the repeal of the Financial Interest / Syndication rules and the enactment of both the Cable Act of 1992 and the Telecommunications Act of 1996.¹ The paper also considers how the production and distribution of movie programming for cable and theatrical release were affected. It shows that these policy changes led to the formation of a vertically integrated oligopoly in television entertainment and a dramatic shrinkage of the role of independent producers of content. The policy changes and resulting alterations in market structure and behavior were not limited to the broadcast sector, however. They also affected the syndication market, cable television and theatrical movies because prime time programming plays a critical role in the overall video entertainment product space. If not amended, these same policy changes could have a major impact upon the ability of independents to offer product through the Internet and other developing digital platforms, including the rapidly approaching digital multi-cast channels.

Over the course of a decade, the content aired on prime time network television, TV syndication, basic and pay cable channels, and theatrical movies came to be dominated by a handful of vertically integrated entities? Dozens of independent entities that produced video

¹ See Chapter III for a discussion of these policy changes and their impact on industry structure.

² See Chapter IV for a detailed description of the changes in program sources that followed the policy and structural changes in the industry.

content were replaced by a handful of firms that own major movie studios and television production units, hold multiple broadcast licenses and own the dominant cable networks. The role of independent producers has been squeezed across all distribution platforms.

By two widely accepted economic measures of market concentration, the Herfindahl-Hirschman Index ($\sum a_i^2$) and the market share of & top four firms (the 4 Firm Concentration Ratio or CR-4), the video market has become a concentrated, vertically integrated, tight oligopoly. As a result, this oligopoly engages in a number of predatory business practices that both limit competition from independents and deprive the public of new, fresh voices. They foreclose the market to independents by leveraging their vertical market power and by self-supplying product. They exercise their market power as buyers of content (monopsony power) with two practices that are especially damaging to competition from independent producers. The first is that networks often demand that they be given an equity participation in an independently developed television series in order for it to be placed on the primetime schedule. The second is that basic cable channels owned by members of the oligopoly will not pay license fees that are commensurate with the production values and the scope of licensed rights they demand in independently produced TV movies.

EFFECT OF THE VERTICALLY INTEGRATED OLIGOPOLY ON THE TELEVISION MARKET

Fifteen years ago, theatrical movie studios and broadcast television were almost entirely separate while cable television was just developing as a primary outlet. In each of these markets, there was a substantial independent sector. Major studios provided about one third of product shown on network prime time television while the networks themselves accounted for just 15%. Non-major studios, known as “independents,” supplied nearly one

half. One set of independents sold movies to broadcasters. Another set sold series and other programming. A few produced and sold both. Vertical integration has changed that situation.

The vertically integrated major studios and broadcasters now account for over 75% of broadcast prime time television programming while independents account for less than 20%.

~~The few independents that get on prime-time television produce reality shows, no scripted~~
programming. As a result, independents have been virtually shut out of the lucrative syndication market, now accounting for just 18% of all first run syndication programming hours and none of the programming hours for shows that have gone into syndication over the last two years.

The economic terrain of cable television has also changed for independents. The vertically integrated media companies own 24 of the top 25 cable channels. The independents' share of pay cable programming also continues to decline as a percentage of programming, dropping by some 15% since the late nineties. Independent product was also squeezed out of syndication. Independent product is increasingly consigned to the far less visible and less financially rewarding basic cable channels where license fees are much lower and in many cases inadequate to cover production costs. Additionally, product placed on basic cable does not have the same potential to realize foreign sales that pay cable product enjoys.

The business practices used to accomplish this dramatic shift in the flow of content in the video product space exhibit characteristics that clearly fit the pattern of abuse of market? By controlling distribution and vertically integrating into production, five of the dominant broadcasters have become gatekeepers who favor their affiliated content, restrict access of

³ See Chapter V for a discussion of these business practices and their effect on source diversity and independent production of video content.

independents to the market, and impose onerous terms and conditions on independent producers that have further shrunk the sector.

While it is extremely difficult to assess the impact of the changes in the industry on quality, there is no doubt that the independent sector was a consistent source of innovative and high quality content in both the TV series and movies categories prior to the changes in policy.⁴ Measured by both popularity and awards, the independents more than hold their own when given a chance to reach the public. This quantitative evidence reinforces the celebrated anecdotal evidence – shows like *All in the Family* and *Cosby* – frequently offered about the importance of independent production. It is quite clear that the elimination of independents from the high value TV product spaces – prime time and premium cable – cannot be attributed to poor quality of product. It is more readily attributed to changes in the structure of the industry and the business practices of the dominant, vertically integrated oligopoly.

The key elements of the video entertainment product space fit a pattern that the literature on industrial organization describes as the exercise and abuse of market power.

These elements include:

Market Structure and Market Power

- Market shares that have risen to the level traditionally defined as a source of concern about concentration setting the stage for the abuse of market power.
- Substantial barriers to entry in the industry.
- A history of anticompetitive practices.

Vertical Integration

- Barriers to entry increased by vertical integration.

⁴ See Chapter VI for a discussion of quality.

- The foreclosure of markets to unaffiliated producers through favoritism of affiliated upstream production and the subsequent exit of upstream product suppliers from the market.
- Parallelism and reciprocity among the dominant firms in the oligopoly.
- A rush to integrate and concentrate across the sector.

Monopsony (buyer) power over independent producers

- The imposition of prices that squeeze unaffiliated producers and terms that shift risk onto those producers.
- Indications of a decline of quality in product attendant on the abuse of monopsony power.
- Flooding of downstream outlets with integrated product.

POLICY IMPLICATIONS OF CONSOLIDATION AND INTEGRATION

The swift and massive horizontal consolidation and vertical integration in the industry raises a number of concerns. The analysis of the economic impact of horizontal concentration and vertical integration can be found across many areas of economic activity, but the unique nature and role of video entertainment raises additional, perhaps even greater concerns in non-economic areas. Television and movies, the former in particular, are fundamental to democratic discourse. Television is the dominant medium in terms of time spent on entertainment and news and information gathering? It is overwhelmingly the choice for national campaign advertising. Entertainment on television can be cultural, educational or political. Theatrical releases have a prominent role in the public discourse as well, which films such as *Crash* and *The Passion of the Christ* have demonstrated in recent years.

⁵ Cooper Mark, *Media Ownership and Democracy in the Digital Information Age* (Palo Alto: Stanford Law School Center for Internet and Society, 2003).

Television and movies play **an** important part in the marketplace of ideas. A nation that prides itself on freedom of speech and diversity while simultaneously issuing exclusive licenses to private firms to broadcast content faces a dilemma. **The** issuance of a handful of broadcast licenses in each market in America creates a privileged class of speakers **through** government action. Local governments issue franchises to cable TV operators, which are even more scarce than broadcast licenses on a city-by-city, county-by-county basis.

How one promotes diversity with such a small number of electronic voices, without dictating what content broadcasters should air, becomes a **major** source of concern. If those very valuable and powerful government-granted platforms for reaching the public become the core of a tight oligopoly that dominates other **areas** of expression, **the** concern is compounded.

If dictating content is ruled out by **First** Amendment free speech concerns, but policy makers continue to strive **for** diversity, then the primary option is to build media market structures that disperse the opportunity to speak **as** much as possible within the confines of the granting of licenses and franchises. The principle on which this approach stands is simple. By ensuring a wider opportunity to put content before the public, diversity and discourse are stimulated without dictating the substance of the content supplied.

POLICIES TO PROMOTE DIVERSITY

For much of the twentieth century, **the** Congress and the Federal Communications Commission pursued this goal of diversity by simultaneously dispersing ownership of production and distribution of content. **The** number of media outlets that could be owned by a single entity **was** restricted both within a market (the **local** television multiple ownership

rule)⁶ and across the nation (a national cap) by the national television multiple ownership rule? The amount **of** content aired in prime time that any given network could own was limited as well by the Financial Interest and Syndication Rules (Fin-syn) and the Prime Time Access **Rules**.⁸ Similarly, consent decrees in cases brought by the Department **of** Justice mirrored the Fin-Syn rules.⁹ Other FCC rules prevented Broadcast license holders from owning other **types** of media outlets – e.g. newspapers and cable TV systems (cross-ownership limits)” -- and restricted their ability to engage in cross-media ownership (e.g. radio).” The result was a substantial dispersion of ownership of content.

In the 1990s, the two primary policies to promote diversity **of** ownership of content in broadcasting were eliminated or cut back. **The** Financial Interest and Syndication Rules (Fin-Syn) that governed prime time programming were allowed to expire and the consent decree was also vacated – allowing broadcasters to own **as** much programming as they wanted. The

⁶ 47 C.F. R. 73.355(b), the duopoly rule, lifted the ban on multiple station ownership, but 47 C.F.R. 73.658(g), **the** dual network rule, restricted the combinations of television stations, to disallow dual or multiple network: ownership that involves a combination between ABC, CBS, Fox, or NBC. Citations to **the** rules are currently being reviewed, which generally relaxed **the** restrictions on cross ownership in **the** 1990s and are the latest in **the** evolving regulatory structure.

⁷ 47 C.F. R. s 73.3555(e)

⁸ **The** two rules have always been closely linked *see* Amendment **of** **Part** 73 **of** the Commission’s Rules and Regulations with Respect to Competition and Responsibility in Network Television Broadcasting, 23, FCC 2d 282 (1970). Amendment **of** Part 73 **of** **the** Commission’s Syndication and Financial Interest Rule, 47 FR 32959 (1982), **as** they were in **the** court case that led to their ultimate expiration, *see* Shurz Communication Inc. v. FCC 982 F. 2d 1043, 1049 (7th Cir. 1992).

⁹ Identical consent decrees were entered against the **three** major networks, which followed the Fin-syn **rules** closely. **These** were vacated when in the early 1990s, as the Fin-syn rules were allowed to expire...

¹⁰ 47 C.F. R s 73.3555(d), cross-ownership of broadcast states and newspapers, prohibits **the** common ownership **of** a daily newspaper and a broadcast station in the **same** market.

¹¹ 47 C.F.R. 73.3555(c), the radio-television cross-ownership rule, limits the number **of** TV and radio licenses that can be held within a market.

limits on multiple station ownership were relaxed—allowing them to own **two** stations in the nation's largest and most important markets. A third policy also gave broadcasters the right to carriage on cable systems (**must-carry/retransmission**).¹² The terrain of the American media landscape was dramatically altered by these policy changes **as** the broadcasters moved quickly to use these three new sources of leverage in the video market.

Whether or not Congress anticipated the powerful effect that the policy changes of the **1990s** would have on diversity of ownership of programming is unclear. Although the FCC has created records on these issues in its proceedings subsequent to the changes in policy, the courts have remanded several of its **rules**,¹³ leaving their regulatory status in **flux** and Congress has included a provision that requires frequent review of the **rules**.¹⁴

The FCC continues to have the authority to implement restrictions on media ownership to accomplish the goals that Congress has set in legislating media **policy**,¹⁵ with the exception of the national multiple ownership rule. To the extent that Congress continues to embrace the goal of diversity, the current situation and how the policy changes of the **1990s** created it **are** what matters now. Moreover, since Congress ordered the FCC in the Telecommunications Act of **1996** to periodically review its **rules**, the FCC could conclude that

¹² Cable Television Consumer Protection and Competition Act of **1992**, Pub. L. No. **102-385**, **106 Stat. 1460 (1992)**.

¹³ Indeed, all of the major structural rules written in the late **1990s** have been remanded by the court (broadcast multiple station limits, cable horizontal limits, newspaper cross ownership) or overridden by Congress (national cap).

¹⁴ The **1996** Act provided for a biennial review (Telecommunications Act of 1996, Pub. L. No. **104-104**, **110 Stat. 56 (1996)**). This was later extended to four years (*FY2004 Consolidated Appropriations Act* (Public Law **1108-109**, **118 Stat. 3** et seq. Section **629**) and prohibited the FCC from further reviewing the national cap.

¹⁵ As with the other rules overturned by the courts, in the case of the **Fin-Syn rules**, while the courts rejected the specific FCC rule (*Schurz Communications Inc. v. FCC* **982 F. 2d 1043** (7th Cir. **1992**)), it did not preclude the writing of an alternative **rule**. To date, the FCC has elected not to do so.

the rule changes it has implemented with agency discretion have harmed diversity, a goal that Congress continues to embrace. The FCC could re-institute those policies that successfully promoted source diversity in the past or it could seek new policies that will promote source diversity in the future.

This paper shows that the current policies are not promoting independent production of video content on the major television platforms. Understanding the impact of past rule changes is the first step in the process of re-examining the decline of sources diversity on television. That is the subject of this paper. While the purpose of this paper is not to recommend specific policy changes, it is clear that if policymakers still believe in source diversity, then a change in policy that directly alters the structure and conduct of the vertically integrated oligopoly are is necessary.

OUTLINE

The paper is based on four sources of data:

- Over a dozen interviews with executives involved in the production of content for television, theatrical and video release.
- A review of the academic literature
- A review of the trade and popular press
- A database that charts market shares in every major domestic and foreign platform for exhibition and release of audiovisual product.

Chapter II outlines the basic issues and analytic approaches. It first describes the product space I am studying and then the analytic approach that I take.

Chapter III describes the policy changes and subsequent changes in market structure and conduct of the vertically integrated video entertainment product space. First it examines

the impact of the repeal of the **Fin-Syn rules** on the market structure **of** the video entertainment product spaces. Then it **surveys** the current **state** of the video entertainment product space.

Chapter IV examines the **change** in the sources of content that resulted **from** the **change in market structure**. It begins with aⁿ analysis of prime time and broadcast programming. Then it turns to the patterns of distribution of TV movies, which includes a great deal of cable content. Finally it **assesses** the importance **of** prime time broadcasting to the overall video entertainment product sector.

Chapter V discusses the **impact** of the market structure on the production and distribution of content. The focus is on the gate-keeping **role** of **the** vertically integrated movie/broadcast/cable companies.

Chapter VI reviews that debate over the impact **of** the vertically integrated oligopoly on the quality of programming.

Chapter VII **offers** some concluding observations **on** the role **of the** Internet.

11. DEFINING THE PRODUCT SPACE AND ANALYTIC APPROACH

THE OBJECT OF STUDY

This is a study of the industrial organization of the video entertainment sector – theatrical movies, all forms of television and the sale and rental of tapes and DVDs – in the United States. Because **the** sector is complex, I adopt the following definitions. The sector consists of **six** primary channels for the distribution of content:

- **theatrical movie** releases,
- **prime time** airing of movies and **series** on broadcast television,
- **syndication** on broadcast television in non-prime time slots of both movies and **series**,
- movies and series aired on **pay cable**,
- movies and series aired on **basic cable** networks,
- **Home Video** – i.e. sale/rental of video for viewing on VCR and **DVD** players.

I refer to the overall sector made up of the six distribution channels **as the video entertainment product space**. The Internet has just begun to be used as a means of redistributing video product that 'was originally released **through** one of the other six **outlets**, While **there** are clear indications that it will change the current terrain of **the** video entertainment product space in **the** long run, there are also clear indications that it will not deconcentrate the sector. Already, the networks **are** multicasting current primetime programming through their websites and Internet protocol television (IPTV) channels are coming on line. Internet video on demand services (VOD), such as Cinema Now and Movielink, are gaining visibility and subscribers **as** broadband service penetrates deeper into

the consumer market, but the **same** content producers dominate. Broadcasters **are** poised to receive a substantial increase in **their** ability to distribute content with the transition to digital multicasting. The current single **channel** will be expanded by the granting of rights to **use** spectrum to broadcast up to six channels digitally. **As** such, there is growing concern that the **same** entities that dominate the traditional channels of physical distribution of video entertainment product will **extend** their dominance to the new Internet and digital distribution channels.

The nature and relationship between these channels **has** changed over time. **Terms of art** once applied have stuck, even though they may no longer technically describe the distribution channel.

Theatrical distribution of movies has been around the longest, with **the** commercial industry stretching back to the early **part** of the **20th** century. Television emerged in the 1950s and 1960s. Cable arrived in the 1970s and 1980s. Distribution of video **tapes** began in the 1980s and exploded with the advent of DVDs in the early 2000s.

Traditionally, television was divided between broadcast and cable to reflect the different means **of** delivery. Broadcasters sent signals over the air from TV transmitters (stations) that were licensed by the FCC. Cable signals were sent **from** a head end through a wire, the laying of which was franchised by a local entity. Today, although broadcast signals are still available over-the-air, most **American** households (80% to 90%) get the broadcast product **through** the cable wire or from satellites.

Prime time on broadcast TV was always a focal point of policy because of the huge audience and resources it commanded. Prime **time** was controlled by **the** networks, which also held licenses to operate TV stations in the largest **markets**. They created national

networks by affiliating with independent license holders in markets where they did not hold broadcast licenses directly. The major networks – ABC, NBC and CBS, reach virtually every home in America. Fox is a national network as well, although it may be available in somewhat fewer homes.

Although cable has always been a subscription service, it split into two different distribution channels when pay cable services, like HBO, developed the ability to charge a premium for programming and basic cable became advertiser supported, mimicking broadcast television. Historically, one could draw a clear line between production of content by movie studios and exhibition – the presentation to the public of product – in theaters. The distinction breaks down with live television -- the broadcast is simultaneously produced and distributed. Television also changes the nature of the exhibition from a public space to a private space, although it is still shared in the sense that programming is watched simultaneously, but separately, by large numbers of people. The sale/rental of videos (and the recording of programming) for home viewing (referred to as Home Video) extended the change from a public to a private experience by allowing people to choose when to watch.

ANALYTIC APPROACH: STRUCTURE, CONDUCT PERFORMANCE

The paper applies a framework of analysis known as the structure-conduct-performance paradigm (see Exhibit II-1),¹⁶ which has been the dominant approach to industrial organization analysis for over three-quarters of a century. The premise is simple.

¹⁶ Scherer, F. M. and David Ross, *Industrial Market Structure and Economic Performance* (Boston, Houghton Mifflin: 1990); Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985).

The analysis **seeks** to identify the conditions that determine the performance of markets.¹⁷ It **starts** with basic conditions.¹⁸ On the supply-side these include factors such as technology, product durability, business attitudes and the legal **framework**. On the demand side factors such as price elasticity, cyclical/seasonal patterns, and purchasing methods are included. These interact with characteristics of the market structure, such as the number

¹⁷ Id., p. 4.

We **seek** to identify sets of attributes or variables that influence economic performance and to build theories detailing the nature of the links between these attributes and end performance. **The** broad descriptive model of these relationships used in most industrial organization studies was conceived by Edward S. Mason at Harvard during the **1930s** and extended by numerous scholars.

Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Engelwood Cliffs, N.J., 1985), p. 5, presents a similar view.

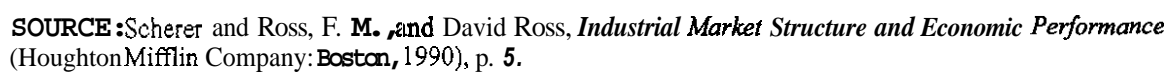
¹⁸ Scherer and **Ross**, p. 5.

Market structure and conduct **are** also influenced by various basic conditions. **For** example, on the supply side, basic conditions include the location and ownership of essential **raw** materials; the characteristics of the available technology (e.g. batch versus continuous process productions or high versus low elasticity of input substitution); the degree of work force unionization; the durability of the product; the time pattern of production (e.g. whether goods **are** produced to order or delivered from inventory); the value/weight characteristics of the product and *so* on. A list of significant basic conditions on the demand side must include at least the price elasticity of demand at various prices; **the** availability **of** (and *cross* elasticity of demand for) substitute products; the rate of growth and variability over time of demand; the method employed by buyers in purchasing (e.g. acceptance of list prices as given versus solicitation of sealed bids versus haggling); and the marketing characteristics of the product sold (e.g. specialty versus convenience shopping method).

¹⁹ Scherer and **Ross**, p. 5.

Conduct depends in turn upon the structure of the relevant market, embracing such features as the number and size distribution of buyers and sellers, the degree of physical **or** subjective differentiation prevailing among competing seller's products, the presence or absence of barriers to entry of new **firms**, the ratio of fixed to **total** costs in **the** short run **for** a typical firm, the degree to which firms are vertically integrated from raw material production to retail distribution and the amount **of** diversity or conglomerateness characterizing individual firms' product **lies**.

The Structure-Conduct-Performance Paradigm



and the size of sellers and buyers, product differentiation, cost structures and vertical integration (the relationship of production and distribution), to determine the conduct of the market participants. The key types of conduct include pricing behavior, product strategy and advertising, and legal tactics.²⁰ Conduct determines performance, traditionally measured in terms of pricing and profits, but increasingly viewed as quality and the nature and speed of innovation.

One of the key features of the structure-conduct-performance paradigm is that it recognizes the importance of public policy. Policies, such as antitrust enforcement, regulation, or taxation and subsidization, can directly affect structure and conduct, thereby altering performance.

HORIZONTAL MARKET POWER

The characteristic of market structures that received most public policy attention is horizontal market power. The concern is that if markets become concentrated—i.e. where a few players have a large market share – competition is dulled. Rather than compete to produce the best product at the lowest price, one large entity may be able to set prices up or otherwise affect output, without a sufficient response from others to discipline such behavior. With small numbers of competitors, they may accomplish the same thing by consciously paralleling each other's behavior. Thus, the Department of Justice defines market power as

²⁰ Scherer and Ross, p. 4.

Performance in particular industries or markets is said to **depend** upon the conduct of sellers and buyers in such **matters as** pricing policies and practices, overt and taciturn interfirm cooperation, product line and advertising strategies, research and development commitments, investment in production facilities, legal tactics (e. g. enforcing patent rights), and so on.

“the ability profitably to maintain prices above competitive levels for a significant period of time.. . **Sellers** with market power also may lessen competition on dimensions other than price, such as product quality, service or **innovation**.”²¹

Pure and perfect competition is rare, but the competitive goal is **important**.²²

Therefore, public policy pays a great deal of attention to the relative competitiveness of markets as well as the conditions that make markets more competitive or workably competitive. Knowing exactly **when** a market is “**too**” concentrated is a complex question. The Department of Justice calculates an index called the Herfindahl-Hirschman Index (HHI) to categorize markets (see Exhibit II-2). This index takes the market share of each **firm**, squares it and sums it. It considers a market with an HHI above 1000 to be concentrated. This is the equivalent of a market with fewer than the equivalent of 10-equal sized **firms**. It considers a market with fewer than the equivalent of approximately 5.5-equal sized firms (HHI = 1800) to be highly concentrated. Markets with an HHI between 1000 and 1800 are considered moderately concentrated.

²¹ Department of Justice/Federal Trade Commission, *Merger Guidelines* (1997).

²² Scherer and **Ross**, p. 16-17.

In modern economic theory, a market is said to be competitive (or more precisely, purely competitive) when the number of firms selling a homogeneous commodity is *so* large, and each individual **firm's** share of the market is *so* small, that no individual firm finds itself able to influence appreciably the commodity's price by varying the quantity of output it **sells**... Homogeneity of the product and insignificant size of individual sellers and buyers relative to their market (that is, *atomistic* market structure) are sufficient conditions for the existence of pure competition, under which sellers possess no monopoly power. Several additional structural conditions are added to make competition in economic theory not only “pure” but “perfect.” The most important is the absence of barriers to entry of new firms, combined with mobility of resources employed.

Exhibit II-2: Describing Market Concentration for Purposes of Public Policy

DEPARTMENT OF JUSTICE MERGER GUIDELINES	TYPE OF MARKET	EQUIVALENTS IN TERMS OF EQUAL SIZED FIRMS	HHI	4-FIRM SHARE (%)
	Monopoly	1 Firm with 65% or more	4250<	100
	Duopoly	2	5000<	100
		5	2000	80
HIGHLY CONCENTRATED	Tight Oligopoly		1800 OR MORE	
		6	1667	67
UNCONCENTRATED	Loose Oligopoly	10	1000	40
1	Atomistic Competition	50	200	8

Sources: U.S. Department of Justice, *Horizontal Merger Guidelines*, revised April 8, 1997, for a discussion of the HHI thresholds; Shepherd, William, G., *The Economics of Industrial Organization* (Prentice Hall, Englewood Cliffs, N.J., 1985), for a discussion of 4 firm concentration **ratios**.

Many economists describe markets in terms of the market share of the top four **firms**.

Shepherd describes these thresholds in **terms** of four-firm concentration **ratios** as follows:²³

Tight Oligopoly: The leading four **firms** combined have 60-100 percent of the market; collusion among them is relatively easy.

Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion **among** them to **fix** prices is virtually impossible.

Although the overlap is not perfect, there is a close correspondence **between** these two approaches. A highly concentrated market is called a tight oligopoly.” A moderately concentrated market is called a loose oligopoly

²³ Shepherd, p. 4.

MONOPSONY POWER

A second economic concept that plays an important part in the video entertainment product space is that of monopsony power. Monopsony power is the flip side of monopoly power. Monopoly power is the power of a seller to dictate prices, terms and conditions as a seller of goods and services to the public. Monopsony power is the power of downstream buyers of inputs to create products to sell to the public and to dictate the prices, terms and conditions on which they buy those inputs. If the upstream suppliers lack alternatives, they may be forced to accept terms that under compensate them or force *them* to bear extra risk. The downstream buyers have market power over the upstream sellers of the product. This can result in the production of fewer or inferior products for sale downstream.

Although monopsony has not been the focal point of much antitrust action, it is more likely in precisely the **type** of sector like the video entertainment product space, where inputs are specialized

Monopsony is thought to **be** more likely when there are buyers of specialized products or services. For example, a sports league may exercise monopsony (or oligopsony) power in purchasing the services of professional athletes. An owner of a chain of movie theaters, some of which are the sole theaters in **small towns**, may have monopsony power in the purchase or lease of movies. Cable TV franchises may exercise monopsony power in purchasing television channels that will be offered to their subscribers?

VERTICAL INTEGRATION AND LEVERAGE

A third key characteristic of many industries is the extent of vertical integration. In many industries the act of producing a product can be readily separated from its distribution and sale. Production is referred to as the upstream, distribution and sale are referred to as the

²⁴ Shepherd, p. 4.

²⁵ Sullivan and Grimes, p. 138.

downstream. Vertical integration occurs when both activities are conducted by one entity.

Because vertical integration involves the elimination of a (presumably market-based) transaction between two entities it has been the focal point of a great deal of analysis.

Economic efficiencies are frequently claimed for vertical integration due to the elimination of transaction costs. Others fear inefficiency and potential abuse of the ability to leverage vertical market power that can result from excessive or unjustified vertical integration.

The classic concern is that distributors of content, who are also producers, favor their own content at the expense of the content of unaffiliated producers. Vertical integration may become the norm in the industry, making it difficult for unintegrated producers to survive. Vertically integrated entities may capture the market for inputs, making it difficult for independent entities to obtain the factors of production necessary to produce product. Also, with vertically integrated entities dominating a sector, reciprocity and forbearance rather than competition may become the norm.

CONCLUSION

The remainder of this paper documents the emergence of a vertically integrated, tight oligopoly in the video entertainment product space. It shows that when public policies that prevented the exercise of market power were relaxed or eliminated, the conditions for the exercise of market power were quickly created by mergers and acquisitions and changes in behavior. The industry became a vertically integrated, tight oligopoly. Vertical leverage was used to eliminate independent production of prime time content. Monopsony power was exercised to squeeze independent film production into a very narrow, niche space on basic cable channels.

111. PUBLIC POLICY AND THE EMERGENCE OF A VERTICALLY INTEGRATED OLIGOPOLY IN VIDEO ENTERTAINMENT

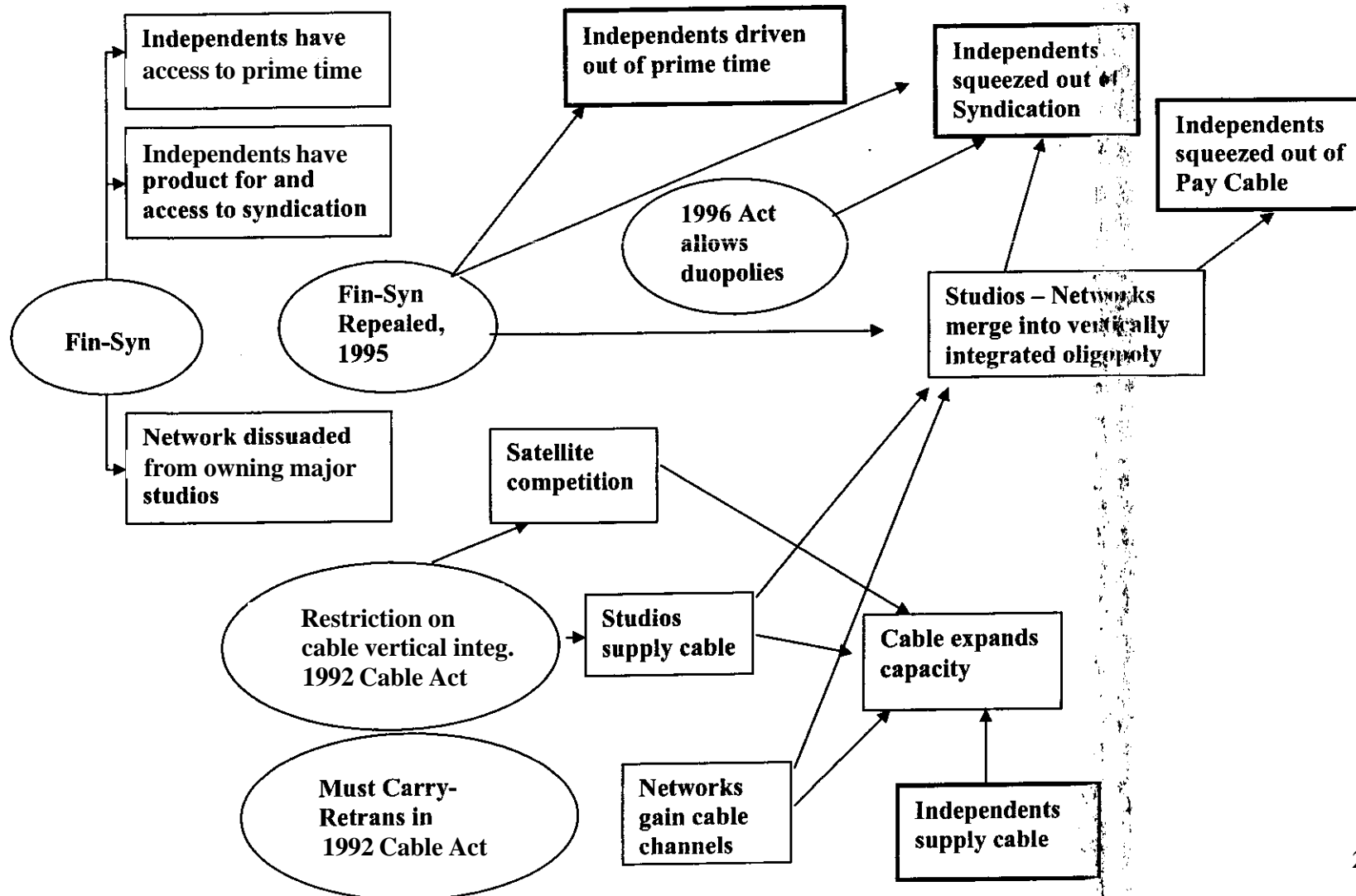
THE REPEAL OF FINANCIAL AND SYNDICATION RULES TRIGGERS HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

At the end of the 1980s, policies to disperse ownership in broadcast television were in place. Though they had been debated intensely throughout the 1980s, the policies remained to limit holders of broadcast licenses to one to a market. These stations were known as O&Os (owned and operated). Holders of broadcast licenses could have O & O stations that reached no more than 25% of the nation's television households. The national broadcast networks were restricted in the amount of content that aired in prime time they could own and their participation in the syndication of non-prime time programming (the Financial and Syndication Rule). The broadcast networks filled out their national networks by entering into affiliation agreements with stations they did not own or operate. There were extensive rules that governed the relationships between the affiliated stations and the networks.

Exhibit III-1 identifies the key policy changes (ovals) and the structural and conduct changes that followed (rectangles) in the 1990s. The primary policy that triggered the vertical integration in the industry was the decision of the FCC to allow the Financial and Syndication Rules to lapse, rather than write rules that would pass court scrutiny. (see Exhibit III-1). In retrospect, it is quite clear that

Exhibit III-1:

The Impact of 1990s Policy Changes on Independents in the Television Market



the Financial and Syndication rules, which restricted the amount of broadcaster-owned programming in prime time, had a major effect on the diversity of not only the broadcast television market, but television in general. When the rules were eliminated in the mid-1990s, broadcasters moved to replace the lion's share of independent programming with content they produced. Self-dealing became the predominant mode of operation.

Ironically, the impact was more profound than the direct effect on prime time. At the time that the Fin-Syn rules were relaxed, restrictions on vertical integration in the cable industry were implemented. Cable operators were restricted in the percentage of capacity on their systems they could fill with programming they owned. In the Cable Consumer Protection Act of 1992 they were also required to make their own programming available to competing delivery systems (the program access rules). As a result of the improved access to programming, satellite competition, which had been anticipated in the 1984 Cable Act, finally increased its market share. Satellite was a digital technology with greater capacity than cable. The cable industry responded by deploying its own digital capacity. Thus, just as the broadcast space was closing, the cable space opened for the majors and independents. The studios, which had been prevented from integrating with broadcasters, funded and supplied programming for cable channels. Given their structure, they could not provide nearly all the programming that a 24/7 channel required. A substantial market for independent movie production opened up.

Majors and independents were not the only beneficiaries of the 1992 Cable Act. The Act also gave the broadcasters a wedge into the cable platform, with the must carry/retransmission rules. Cable operators needed to carry the major broadcast networks to make their basic subscription packages attractive to the public. The Cable Act of 1992 gave the broadcasters